

## SECTOR PROGRAM FOR TRANSPARENCY IN AND REFORM OF FISCAL, SOCIAL AND JUDICIAL POLICY

(PE-0212)

### EXECUTIVE SUMMARY

<b>Borrower and guarantor:</b>	Republic of Peru	
<b>Executing agency:</b>	Ministry of Economy and Finance (MEF)	
<b>Amount and source:</b>	IDB (OC):	US\$250 million
	Total:	US\$250 million
<b>Terms and conditions:</b>	Amortization period:	20 years
	Grace period:	5 1/2 years
	Disbursement period:	6 months
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%
	Currency:	U.S. dollars from the Single Currency Facility
<b>Objectives:</b>	<p>In the short term, the objective of this operation is to develop a legal framework for introducing transparency and accountability in fiscal policy, and to protect spending on the social and justice sectors in the context of fiscal equilibrium. In the medium term, the objective is to develop public policies based on a process of participation by civil society to ensure transparency and accountability and improve governance in a democratic context.</p>	
<b>Description:</b>	<p>The design of this operation incorporates two factors. The first is the existence of a window of opportunity, a function of Peruvian conditions in 2001, marked by an electoral process that will result in a mid-year change in administration and the Congress, in which the present government will not participate. The present administration has made it clear that it intends to prepare the groundwork for an orderly transition of power and to introduce mechanisms that ensure transparency in the State's activities. The second factor is that the State reform needed to restore credibility and governance is a long-term goal that exceeds the scope of a single operation. This</p>	

single-tranche loan is the first operation in a US\$500 million program of sector loans for the year 2001, which may be supplemented by other operations still to be agreed on with the new authorities. This format has significant advantages, since it affords both the country and the Bank the ability to adapt to the change of government and allow the window of opportunity being presented in this political transition stage to be exploited. The conditions contained in the policy matrix were fully satisfied prior to submission of this operation to the Board of Executive Directors.

To promote the fulfillment of the objectives relating to the protection of spending on the social and justice sectors, mechanisms were created to contribute to civil society's ability to begin exercising control over these expenses. To ensure the sustainability of this operation's objectives in the medium term, plans have been made to carry out a number of studies and activities, and to create mechanisms for consultation with civil society. Such activities will be financed through a special fund established by supreme decree specifically for these purposes.

The conditions fulfilled by the government as described below are oriented toward increasing transparency and accountability in:

**Fiscal policies and institutions.** There is a legal basis for ensuring public access to government financial information in order to: i) eliminate the distortions in the information available to the authorities and the public; ii) reduce opportunities for arbitrariness, a situation that favors corruption; iii) improve civil society's ability to participate in government decision-making; and iv) strengthen governance in order to achieve effective democracy. The new legal basis is the result of an emergency decree containing regulations to allow public access to fiscal information and provide for the publication of detailed public finance data by budgetary and off-budget institutions, and an interactive system that affords access to additional information and greater transparency in the budget process by simplifying the submission of information such as tax expenditures and fiscal risk. Lastly, institutional coverage of the budget control exercised by the MEF has been expanded, and the Defense and Interior sectors have been included within the regular public financial administration cycle.

**Anti-poverty and social protection policies and institutions.** Actions have been carried out in order to: i) protect antipoverty and poverty relief programs from budget cuts and to introduce mechanisms to make the authorities accountable to civil society for completing this measure; ii) reduce breakdowns in coordination and

improve the State's ability to react to random shocks such as economic crises and natural disasters, including the creation of mechanisms for monitoring and for ensuring participation by civil society; and iii) set the stage for comprehensive reform of the country's social safety networks.

**Justice policies and institutions.** The groundwork has been laid for: i) formally establishing an anticorruption and public ethics building program; ii) reinitiating reform of the administration of justice system by ensuring its independence and participation by civil society; and iii) protecting spending on justice from budgetary cutbacks.

The Government has also fulfilled two special conditions relating to macroeconomic equilibrium and the implementation of subsequent actions to ensure the sustainability of this operation's medium-term objectives:

- a. **Macroeconomic stability.** The Executive Board of the International Monetary Fund has approved the agreement with that institution.
- b. **Special fund for subsequent actions.** A Supreme Decree has been issued authorizing the allocation of resources to prepare the foundation for facilitating the design of future reforms in the three areas of the sector program.

**The Bank's country and sector strategy:**

The Bank strategy as described in the country paper (GN-1992-1) emphasizes the need for a second generation of reforms, with a focus on efforts to reduce poverty and modernize the State. Both remain as crucial topics on the political agenda. This project reflects the Bank's response to these special circumstances affecting the country. This operation hinges on projects now under way to assist Peru with the first generation of reforms, paving the way to comprehensive reform of the public sector and the social safety net system.

**Environmental review:**

As to its environmental impact, the operation focuses on policy actions that require no measures involving civil works or other actions that might have any direct environmental impact. It was also reviewed by CESI on 9 February 2001.

**Benefits:**

In the short term, the program's primary benefit will be to initiate the creation and implementation of participative processes at different points of the public decision-making chain, in three of the areas considered as being most important for ensuring sustainability of the conditions required for development. To that extent, introducing participative mechanisms and the means of ensuring the fulfillment of government plans strengthens the country's democratic institutions,

improving governance and consequently enhancing the conditions for development.

At the same time, subsequent actions to be commenced after the Board's approval of the operation will also yield considerable benefits in the medium term. The new administration that assumes power on 28 July will have a unique opportunity to deepen the process of structural reform, having at its disposal an array of diagnostic assessments and proposals for strengthening the fiscal, social and justice sectors.

**Risks:**

Since this sector loan involves a single tranche only and all the conditions stipulated in the policy matrix have been fulfilled, there are no risks that jeopardize the operation's objectives or disbursement in full of the resources.

However, the operation's design incorporates factors that go beyond loan disbursement and the government's term of office. Subsequent actions in the fiscal, social and justice sectors as described in chapter three must be executed after disbursement in full of the loan. There is therefore a risk that, since they are not disbursement conditions, and are financed, at least in part, through budgetary allocations, some of these activities will not be fulfilled. This risk is minimized through the creation, by supreme decree, of a special fund to finance these actions, with specific objectives and sufficient funds, as described in chapter three, as well as by a program fulfillment and impact evaluation. The policy letter submitted by the government and published also make clear the commitment to execute the actions proposed.

Legislation regulating access by the public to government information by means of an instrument not requiring prior discussion or consensus, such as the Emergency Decree, could adversely affect how deeply its provisions are accepted by the public, thus leading to subsequent amendments. Many of the provisions contained in the standards will have practical effect and force of law when the new Congress sits owing to the fact that since March 2001 information has been posted on the MEF website and the main presidential candidates and most political parties in the Legislature promoted this initiative during the election campaign.

Although this operation is self-contained and self-justifying, it also falls within the framework of medium-term reforms. Transparency in public finance, protection of the most vulnerable social sectors, and strengthening the process of reforming the administration of justice are only the first steps; they must be accompanied by a deeper reform of the State. If these subsequent reforms are not carried out, the consistency and integrity of the country's long-term reforms could be

jeopardized. Despite the fact that the political situation makes it difficult to mitigate this risk, the technical studies forming part of this operation will provide subsequent information to assist the next administration in becoming familiar with the State's areas of greatest weakness, as well as specific proposals for strengthening them.

**Special contractual clauses:**

The loan agreement will include the conditions set forth in the Policy Matrix (Annex I-1) and will state that the Policy Letter (Appendix I) is an integral part of the loan.

**Poverty-targeting and social sector classification:**

This operation is classified as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). Programs for combating and alleviating poverty, which are to be protected under the program, play a fundamental role in sustaining the living conditions of the marginalized population, including women and indigenous peoples in extreme poverty.

**Exceptions to Bank policy:**

None

**Procurement:**

Not applicable